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RUEHNZ/AMCONSUL AUCKLAND 0391
RUEHDN/AMCONSUL SYDNEY 0799
RHHJJAA/JICPAC HONOLULU HI
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C O N F I D E N T I A L SECTION 01 OF 03 SUVA 000149

SIPDIS

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TAGS: EFIN PGOV ECON MARR ASEC FJ

SUBJECT: FIJI'S REVISED BUDGET MIXES SPENDING CUTS WITH
WISHFUL THINKING

REF: SUVA 127

Classified By: Ambassador Dinger per 1.4 (B,D)

Summary

¶1. (C) Fiji's revised budget is a mix of modest spending cuts, optimistic revenue projections and wishful thinking about the future. Civil service wages are being cut 5% effective March 8. A few ministry budgets have been significantly reduced, most notably the Ministry of Fijian Affairs. Defense expenditures are slated to drop, leading a number of commentators to question the credibility of the budget, in light of huge coup and post-coup military expenses. To raise revenue, tariffs will rise on a number of "luxury" items, and the visitor departure tax will increase. Government revenues are projected to increase over 2006, even though GDP is predicted to decline 2.5%. The budget resurrects oft-mentioned plans to increase sugar output, diversify tourism markets and again create a Fiji-based bank. The interim government proposes to deal with its reserve shortfall by borrowing off-shore, at rates it hopes will be comparable to pre-coup levels. In our view, the budget is unlikely to either stabilize Fiji's finances or pave the way for renewed economic growth. Prospects for significant economic improvement are dim unless Fiji takes credible steps to return to democracy quickly.

Budget "A Bitter Pill"

¶2. (U) Interim Finance Minister Chaudhry announced Fiji's revised budget March 2, leading off with the statement that Fiji's finances are "at its worst state ever." Budget and spending cuts contained in the revised budget, he said, "will undoubtedly come as a bitter pill to many of our people. But frankly, I am left with no other choice." Chaudhry blamed the deposed Qarase government for Fiji's economic plight, and said the budget would begin the process of restoring financial stability and rebuilding Fiji's economy. He said GDP would decline by 2.5% in 2007 (compared with the 2-4% decline he and the Fiji Reserve Bank predicted in February, reftel), but would show 2% growth in 2008.

Cuts in Civil Service Wages, Spending

¶3. (U) Chaudhry made the long-expected announcement that civil service wages would be cut by 5%, effective March 8. He said the interim government would review the back-pay and COLA agreements the government reached with unions just prior to the 2006 elections. Salaries of interim ministers, on the other hand, will not be cut, based on the argument that

interim ministers are already making less than ministers in the Qarase government did.

14. (U) The budgets of most ministries were cut from the Qarase government's 2007 budget, with the Ministry of Fijian Affairs taking the biggest hit, down more than 34%. That cut has been clearly noted by the ethnic Fijian community, leading pro-regime commentators and interim Fijian Affairs Minister Ganilau to attempt to downplay its significance. Also hard hit was the Fiji Visitors Bureau, with Chaudhry arguing that the private sector should provide one-half of its budget. The military budget was cut from the planned FJ\$85.9 million to FJ\$80.7 million (USD 49 million). Agriculture and infrastructure (water and road projects), on the other hand, both received significant increases. (The infrastructure increase presumably factors in ADB new project funding yet to be finalized.) Overall government spending is scheduled to decrease by about FJ\$140 million (USD 83 million) from the Qarase budget. Additional long-term savings are considerable if the proposed termination of scheduled back-pay and COLA payments for civil servants is figured in.

Defense Budget Figures Questioned

15. (SBU) In interviews over the weekend, Chaudhry insisted that he wouldn't tolerate overspending by ministries. No supplementary allocations will be forthcoming. In an editorial March 6, the Fiji Times challenged that statement, noting that Chaudhry did not tell taxpayers how the interim government will pay for military operations during and after the coup. The Times surmised that the interim government would announce a supplementary budget later in the year.

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(Comment: The Fiji Times editorial is right on target. The seemingly impossible "reduction" in military spending contained in the revised budget would seem to call into question the entire document's credibility. End comment.)

Revenues From Tariff Increases on "Luxury Items," Higher Departure Tax

6 (SBU) The revised budget does not include any significant changes to tax rates. Tariffs were increased on a large number of "luxury items," ranging from perfumes to jewelry to household appliances. The departure tax was also increased, from the current FJ\$25 to FJ\$40 (US\$25). Tariffs were reduced on a few food items, such as milk, cheese, and, strangely, potato chips (though Chaudhry's feud with FMF's Hari Punja offers a clue). While revenue estimates are well below those projected in the Qarase budget, they still represent a 6% increase from 2006 levels. A number of commentators have observed that Chaudhry's revenue projections appear remarkably optimistic given the predicted GDP decline. (Note: The tariff increases target items purchased by Fiji's middle and upper classes. The cuts in food tariffs are not as deep or wide-ranging as some of our contacts had predicted (reftel). End note.)

Looking Into the Future - Chaudhry Sees Deregulated Telecommunications Industry, Sugar Boom, A New Bank

17. (SBU) Chaudhry announced a number of medium and long-term initiatives that will be "explored" to improve the economy. He offered few details on how these objectives would be accomplished. Initiatives include:

- increasing sugar exports by 33% over the next three years. (An unstated but clear assumption is that large-scale EU sugar reform aid will flow shortly);
- deregulating the telecommunications industry;
- increasing tourism from East Asian and Southeast Asian markets;
- promoting Fiji as a movie location;
- promoting import substitution, especially for agricultural

products that could be used in the tourism sector;
--encouraging the private sector to establish a new Fiji-based bank; and
--developing an equitable land tenure framework.

Offshore Borrowing to Prop Up Reserves?

¶ 18. (SBU) In the budget presentation, Chaudhry said the interim government would explore borrowing overseas instead of domestically. In media interviews over the weekend, Chaudhry explained that domestic borrowing is simply too expensive, with interest rates at about 10%. He flatly stated that borrowing from the Fiji National Provident Fund (FNPF) would halt. Fiji can borrow overseas, he said, at about 7%. The new funds will help build up Fiji's reserves, while the US\$150 million borrowed on overseas markets by the Qarase government will be "brought in" to help cover debt repayments and other expenses. (Comment: Fiji will not be able to borrow overseas at anything close to the 7% interest rate quoted by Chaudhry. Investors who purchased shares of the US\$150 million bond issued by the Qarase government at a 7% interest rate last September, when Fiji's prospects looked bright, lost a bundle after the coup. Once burned, international investors are unlikely to be enthusiastic about a new Fiji offering. Another interesting issue is who will pay interest to the FNPF (aka Social Security). The Government has been the dominate taker of FNPF paper in the past, to the benefit of Fiji's retirees. End comment.)

Comment: A Dose of Realism Needed

¶ 19. (C) We fail to see how this budget will do much to stabilize Fiji's finances or pull it out of recession. It may have a negative impact on both counts. In failing to disclose the true level of military spending and the costs of the coup, the interim government confirms the impression that it has plenty to hide - not a very encouraging climate for potential new investors or purchasers of Fiji bonds. In adding new fees for tourists and cutting tourism promotion spending, the interim government risks damaging the one industry that has the potential of helping Fiji out of its economic mess. Announced plans to borrow off-shore appear naive and unrealistic, and will do little to solve Fiji's

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reserves crisis. If a devaluation is in Fiji's future, repaying off-shore loans will be especially difficult.

¶ 10. (C) Some of our contacts have expressed disappointment that the interim government did not use this opportunity to radically restructure the civil service or take other needed steps to reform Fiji's economy (the one exception being Chaudhry's advocacy of telecom deregulation which was already in the works pre-coup). Indeed, other than ensuring that special benefits doled out by the SDL to its supporters were terminated, there is little appetite in this budget for major reforms. Instead, the budget attempts to reassure Fiji's citizens and the international community that economic normalcy will soon be restored. Thus the budget's optimistic revenue figures, its reliance on a revitalized tourism industry to pay the bills, and Chaudhry's faith that sugar production can be ramped up. The budget also assumes that aid projects will continue and that international investors will flock to buy Fiji bonds at pre-coup rates. What the interim government apparently fails to realize is that Fiji's economy cannot "return to normal" until democracy returns to Fiji. We expect a very difficult economic year and a recession that could well be even deeper than the 2.5% contraction Chaudhry predicts.

DINGER